No. 15024

In the
United States Court of Appeals
For the Ninth Circuit

GEORGE WESLEY STONE and HILDEGARDE W. STONE,
Appellants,

vs.

JACK W. S. FARNELL and ELISABETH PATTEE FARNELL,
Appellees.

Appeal From the United States District Court for the Southern District of California, Central Division.

Appellants' Brief

LEO SHAPIRO
215 S. Las Cienega Blvd.,
Beverly Hills, California
OLympia 2-2003
Attorney for Appellants.

TOPICAL INDEX

TABLE OF CASES AND AUTHORITIES CITED

Cases

Codes, Statutes, Texts, etc

In the
United States Court of Appeals
For the Ninth Circuit

GEORGE WESLEY STONE and HILDEGARDE W. STONE, *Appellants,* vs. JACK W. S. FARNELL and ELISABETH PATTEE FARNELL, *Appellees.*	No. No. 15024

Appellants' Brief

JURISDICTION

This case is before the Court upon an appeal taken by George Wesley Stone and Hildegarde W. Stone from a judgment of the United States District Court for the Southern District of California, Central Division, docketed and entered on November 29, 1955, awarding appellees damages against appellants in the sum of $15,000; denying appellants recovery on their counterclaim for foreclosure as a mortgage of the deed of trust described in said counterclaim; and ordering

the cancellation of the said deed of trust. This Court has jurisdiction of this appeal. (28 U.S.C. Sec. 1291.)

STATEMENT OF THE PLEADINGS

The proceedings were initiated by a complaint filed by appellees in the Superior Court of the State of California in and for the County of Los Angeles on the 14th day of January, 1955. The complaint alleges that appellees, in reliance upon certain representations alleged to have been falsely and fraudulently made by appellants, purchased the real property described in the complaint for the sum of $38,000; that said property was not as represented and was actually worth no more than $18,000. The relief sought was the recovery of damages in the sum of $20,000, and the cancellation of a promissory note and second deed of trust given as part of the purchase price. The proceedings were removed to the United States District Court for the Southern District of California, Central Division, upon a petition for removal filed by appellants. The petition alleged that appellants were citizens and residents of the State of New York, and not citizens or residents of the State of California; that the plaintiffs in said action were citizens and residents of the State of California; that said action involved a controversy wholly between citizens of different states, in an amount in excess of $3,000, and by reason of which facts the United States District Court had exclusive jurisdiction. *(28 U.S.C.* sec. 1332.) The petition for removal is found at page 3 of the Transcript of Rec-

ord; a copy of the complaint filed in the Superior Court of the State of California is attached as Exhibit "A" to said petition. (Transcript of Record, p. 8.)

Upon the removal of the proceedings to the United States District Court, appellants filed their answer to the complaint, denying that they had made any false or fraudulent representations in connection with the sale referred to, and by way of counterclaim alleged that plaintiffs in said action had defaulted in the payment of the monthly installments of principal and interest under a second deed of trust executed by them to secure the payment of part of the purchase price of said property; appellants by said counterclaim sought to foreclose the said deed of trust as a mortgage. The answer and counterclaim is set forth commencing at page 25 of the Transcript of Record. Appellees filed their answer to the counterclaim, in which they admitted that monthly payments on the said deed of trust had not been made from and after February 5, 1955, and alleged as justification for said non-payment the matters referred to in the second cause of action of their complaint. (Transcript of Record, p. 37.) Although Bank of America was named as an additional defendant on said counterclaim, at the conclusion of the trial appellants dismissed in open court as to said defendant. (Transcript of Record, p. 156.)

STATEMENT OF THE CASE

The evidence shows that appellees agreed to buy, and appellants agreed to sell, for a total consideration of $38,000, the property described in paragraph I of the complaint, located at 13751 Mulholland Drive, Los Angeles, California, consisting of the main residence, guest house, carport, cesspool and septic tank, swimming pool, walks, driveway, landscaping and other appurtenances. Approximately seven or eight months after the consummation of the sale, and as a result of a survey made by appellees, the parties learned for the first time that approximately one-third of the main residence, the carport, the guesthouse, the cesspool and septic tank, and portions of the walks, driveways and landscaping, and other appurtenances, were not on the property as described in paragraph I of the complaint, and that the said improvements were located on property belonging to the City of Los Angeles as part of Mulholland Drive. Appellees did not rescind the transaction or give notice of rescission thereof, but instead commenced their action for the recovery of damages.

Jack W. S. Farnell testified that Mrs. Stone pointed out the boundaries of the property, (Transcript of Record, p. 114), and told him that all the improvements were on the property. (Transcript of Record, p. 115). He admitted that he had no conversations with Mr. Stone. (Transcript of Record, p. 115). Mrs. Farnell's testimony was substantially to the same effect. Transcript of Record, p. 128).

P. D. Baehr, an appraiser, testified that the market value of the property as it actually existed, was $10,600. (Transcript of Record, p. 79).

Henry Bernasconi, a house mover, testified that the cost of moving the main house on to the property would be $7,400, and that the cost of moving the guest house would be $3,380. (Transcript of Record, pp. 94 and 95). There was no other evidence of damage.

Mr. Stone testified, in response to questioning by Judge Harrison, that he bought the property on September 15, 1952; that when he bought it he assumed that all of the improvements were on the property, and that when he sold it he likewise assumed that all of the improvements were on the land. (Transcript of Record, pp. 132 and 133). He testified that he had no information to the contrary until after Mr. Farnell had the survey made, (Transcript of Record, p. 132), which, as previously stated, was some seven or eight months after the sale was completed. He testified further that while he owned the property a fire occurred which destroyed about 80% of the house; that he collected approximately $15,100 in insurance, and rebuilt the house on its original foundation at a cost in excess of $26,000. (Transcript of Record, p. 132).

Mrs. Stone testified that prior to the sale, and when Mrs. Farnell was looking over the property, she gave Mrs. Farnell a map or sketch which she had obtained from Keith Daniels, from whom the Stones purchased the property. (Transcript of Record, p. 138). This map or sketch showed that all of the improvements

were on the property except two feet of the carport, which to that extent encroached on Mulholland Drive. This was not denied by Mrs. Farnell. Mrs. Stone denied that she had any discussions or conversations with the Farnells regarding the location of the improvements on the lot except as above stated. She testified that she had no other information regarding the location of the south boundary other than the map or sketch given to her by Mr. Daniels, the former owner. The Farnells made no protest or comment concerning the fact that the map showed that two feet of the carport was on city property. (Transcript of Record, p. 142). The map or sketch referred to by Mrs. Stone, given by her to Mrs. Farnell, was not produced by the Farnells and was not offered in evidence. Mr. Farnell admitted receiving the map. (Transcript of Record, p. 122).

It was stipulated in open court that the Farnells had not made the payments on the second trust deed. (Transcript of Record, p. 148).

THE QUESTIONS INVOLVED

I.

In an action at law for damages for fraud and deceit based upon representations alleged to have been falsely and fraudulently made, as distinguished from an action in equity for rescission, there being no evidence of actual knowledge on the part of appellants that the representations were false and untrue, are appellees entitled to judgment for damages in the absence of proof that appellants had no reasonable ground for believing the representations to be true?

II.

Where the evidence shows that the representations made by appellants as to the boundaries and location of improvements on the property were based upon a map or sketch and other information obtained by them from their vendor, and where this evidence is uncontradicted, does not this establish as a matter of law that appellants had reasonable ground for believing the representations made by them to be true?

III.

Where the complaint charges appellants with the making of false and fraudulent representations in order to induce appellees to purchase their property, and it was stipulated that a mistake was made as to the boundaries of the property and the location of the improvements, are the allegations of fraud sustained by proof of mistake?

IV.

Where appellees, prior to the purchase of the property, were given a map showing that two feet of the carport encroached on city property, and this fact is not denied, was this not notice to appellees sufficient to put them on inquiry as to the true boundary line and the location of the improvements, and were they not thereby estopped from relying upon the representations alleged to have been made by appellants?

V

Is the Conclusion of Law that appellants committed both constructive and actual fraud supported by the Findings of Fact when there is no finding that the representations made by appellants were either known by them to be untrue, or made in a manner not warranted by their information?

VI.

In the absence of a finding of the value of the property actually received by appellees, is there any basis or support for the Conclusion of Law that appellees are entitled to judgment for $15,000?

VII.

In the absence of Findings of Fact upon the following material issues:

(1) Were the representations made by appellants with knowledge of their falsity?

(2) Were the representations made by appellants in a manner not warranted by their information, or recklessly and carelessly and without an honest belief in their truth?

(3) Were the statements and representations alalleged to have been made by appellants, as set forth in paragraph III, subparagraphs 1, 2 and 3 of the complaint, fraudulently made as alleged in paragraph IV of the complaint?

(4) Did appellants fraudulently represent to appellees that all of the improvements were on their land, as alleged in paragraph X of the complaint?

(5) Did appellants fraudulently represent to appellees that the property being sold to them was well worth the purchase price of $38,000, as alleged in paragraph XI of the complaint?

is there any support or basis for the Court's Conclusions of Law that appellants committed both constructive and actual fraud under California law, and that appellees are entitled to judgment against appellants, as stated in the Conclusions of Law?

VIII.

Upon the evidence in the record, are appellants entitled to judgment against appellees upon their counterclaim and should the judgment appealed from be reversed with instructions to the court below to enter judgment in favor of appellants for the foreclosure as a mortgage of the deed of trust referred to in their counterclaim, in accordance with the prayer thereof?

SPECIFICATION OF ERRORS UPON WHICH APPELLANTS RELY

I.

Paragraph I of the Conclusions of Law that appellants committed both actual and constructive fraud under California law is not supported by the evidence.

(a) There is no evidence of actual knowledge on the part of appellants that the representations alleged to have been made by them were false and untrue.

(b) There is no evidence that appellants had no reasonable ground for believing the representations to be true.

Proof of either (a) or (b), i.e. scienter, is essential in an action for damages for fraud and deceit.

(c) The representations made by appellants were based upon a map and information obtained by them from their vendor, which they believed to to be true, and upon which they relied; this establishes reasonable grounds for their belief in the truth of the representations as a matter of law.

II.

Paragraph I of the Conclusions of Law that appellants committed both actual and constructive fraud under California law is not supported by proof of mistake.

(a) There is no evidence of fraud, either actual or constructive.

(b) It was stipulated that there was a mistake as to the boundaries; this is not the equivalent of fraud.

III.

Paragraph I of the Conclusions of Law that appellants committed both actual and constructive fraud under California law is not supported by the Findings of Fact.

(a) There is no Finding of Fact that:
   1. The representations were made by appellants with knowledge of their falsity, or
   2. In a manner not warranted by their information, or
   3. Recklessly or carelessly, and without an honest belief in their truth.

(b) There is no Finding of Fact that the statements and representations alleged to have been made by appellants, as set forth in paragraph III, subparagraphs 1, 2 and 3 of the second cause of action of the complaint, were fraudulently made.

(c) There is no Finding of Fact that appellants fraudulently represented that all of the improvements were on their land, and that good and valid title thereto was transferred to plaintiffs, as alleged in paragraph X of the second cause of action of the complaint.

(d) There is no Finding of Fact that appellants fraudulently represented that the property being sold was worth the purchase price of $38,000, as alleged in paragraph XI of the second cause of the action of the complaint.

The failure to find upon each of these issues is reversible error.

IV.

Paragraph II of the Conclusions of Law that appellees have a right to sue for damages is not supported by the evidence or the Findings of Fact.

(a) For the reasons assigned in the foregoing specifications appellees have not established a cause of action against appellants, and the judgment in favor of appellees against appellants is contrary to the law and the evidence, and can not be sustained.

V.

Paragraph III of the Conclusions of Law that appellants are not entitled to foreclose the deed of trust set out in their counterclaim, and that said deed of trust and the note secured thereby should be cancelled, is not supported by the evidence or the Findings of Fact.

(a) The note and deed of trust are admittedly in default, and the Court erred in denying appellants judgment on their counterclaim.

VI.

Paragraph IV of the Conclusions of Law that appellees are entitled to judgment in the sum of $15,000 is not supported by the evidence or the Findings of Fact.

(a) There is no Finding of Fact as to the value of the property actually received by appellees. This is essential in order to determine the difference between the price paid and the value of the property received, which is the measure of damages under the "out of pocket" rule.

(b) There is no evidence as to the value of the furniture in the guest house included in the purchase.

The failure to find on these issues is reversible error.

VII.

That portion of paragraph IV of the Findings of Fact that it is untrue that the land as it actually existed was worth $38,000 is not supported by the evidence.

VIII.

That portion of paragraph V of the Findings of Fact that it is true that appellees relied upon appellants' representations is not supported by the evidence.

(a) Appellees had notice sufficient to put them on inquiry as to the boundaries and location of the improvements by a map showing the true

boundaries and location of the improvements, and were estopped from relying upon the representations alleged to have been made.

IX.

Paragraph VII of the Findings of Fact, in which it is implied that appellees did not have knowledge of the boundaries and the location of the improvements, is not supported by the evidence.

(a) The evidence shows that appellees had notice sufficient to put them on inquiry as to the boundaries and location of the improvements as stated in VIII (a) hereof.

X.

Paragraph VIII of the Findings of Fact, that it is true that as a direct and proximate result of appellants' misrepresentation appellees were damaged in the sum of $15,000, is not supported by the evidence.

(a) For the reasons assigned in the foregoing specifications the misrepresentations alleged to have been made by appellants, are not actionable and appellees have not been damaged.

ARGUMENT

I.

There Is No Evidence in the Record That Appellants Had Either Actual Knowledge of the Untruth of the Statements Made by Them, or That They Lacked an Honest Belief in Their Truth, or That They Were Made in a manner not Warranted by Their Information; Nor Is There a Finding That Appellants Had Either Actual Knowledge of the Untruth of the Statments, or That They Lacked an Honest Belief in Their Truth, or That They Were Made in a Manner Not Warranted by Their Information. In the Absence of Such Evidence and of a Finding Thereon, the Judgment Against Appellants Can Not Be Sustained.

It should be borne in mind that this is an action at law for damages based upon the alleged fraud of appellants, as distinguished from an action in equity for rescission. It is well established that the plaintiff in an action for fraud or deceit based upon misrepresentation must show that the representation was false and known to be false by the party making it, or else made recklessly or without reasonable grounds for believing its truth.

23 Cal. Jur., 2d, 27, §11.

The elements of actionable fraud and deceit have been codified in California. Actual fraud is defined by §*1572* of the California Civil Code as an act committed by a party to a contract with intent to deceive such other party, or to induce him to enter into the contract, which is either:

"1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;

"2. The positive assertion, *in a manner not warranted by the information of the person making it,* of that which is not true, though he believes it to be true;" (Emphasis supplied).

Section 1710 of the California Civil Code defines deceit as either:

"1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;

"2. The assertion, as a fact, of that which is not true, *by one who has no reasonable ground for believing it to be true; . . .*" (Emphasis supplied).

Thus either actual knowledge or the assertion as a fact in a manner not warranted by the information is the gist of the action.

The rule is stated in *1 Black* on *Rescission and Cancellation* (Second Edition) 313, §106, as follows:

"An action at law for fraud or deceit cannot be maintained unless a guilty knowledge, actual or constructive, is established, either by showing that the representation was false within the knowledge of the person making it, or that he made it as a positive assertion calculated to convey the impression that he had actual knowledge of its truth when he was conscious that he had no such knowledge, or that the statement was made recklessly and without knowing or caring whether it were true or false. For fraud implies the doing of a wrong willfully; and hence an innocent mis-

> representation made through mistake without knowledge of its falsity, or which is honestly believed to be true, and made with no intention to deceive, is not actionable fraud."

The rule is similarly stated in *23 Cal. Jur.* 2d, 64, §26:

> "A necessary element of actual fraud is the intent to deceive or the intent to induce one to enter into a transaction. Furthermore, a fraudulent misrepresentation, to be actionable, must be made with knowledge that it is or may be untrue. Ordinarily, therefore, fraud can not be predicated on statements made by one who believes in, and has no reason to doubt their truth."

Since jurisdiction in this case is based solely on diversity of citizenship, the California substantive law controls. *Erie Railroad Co. v. Tompkins,* 1938, 304 U. S. 64.

It is well established by the California cases that the plaintiff in an action for damages for fraud must plead and prove, and the Court must find, a false representation of a material fact made with knowledge of its falsity, or in a manner not warranted by the information available to the defendant. *Wishnick v. Frye,* 111 Cal. App. 2d, 926, [245 Pacific 2d 532], is one of the more recent California cases establishing this rule. There the plaintiff brought an action to recover damages for fraud and deceit, and recovered judgment for $14,180.00. The judgment was reversed on appeal. At page 930 of 111 Cal. App. 2d, the Court states:

"Of the several points urged by appellant in attacking the judgment, we believe that a consideration of his argument that the judgment cannot be sustained in view of the absence of a finding of scienter suffices to dispose of this appeal. The elements of actionable fraud, which must be pleaded and proved if a plaintiff is to prevail, consist of a false representation of a material fact, made with knowledge of its falsity and with the intent to induce reliance thereon, upon which plaintiff justifiably relies to his injury. *(Blackman v. Howes,* 82 Cal. App. 2d 275 [185 P. 2d 1019, 174 A.L.R. 1004]; *Podlasky v. Price,* 87 Cal. App. 2d 151, 158 [196 P. 2d 608].) *The omission of a single one of these elements in an action for deceit will normally prevent recovery. (Gonsalves v. Hodgson,* 38 Cal. 2d 91 at p. 100 [237 P. 2d 656]; *Cox v. Westling,* 96 Cal. App. 2d 225, 229 [215 P. 2d 52].) In order to satisfy the requirement of scienter, it may be established either that defendant had actual knowledge of the untruth of his statements, or that he lacked an honest belief in their truth, or that the statements were carelessly and recklessly made, in a manner not warranted by the information available to defendant. *(Gonsalves v. Hodgson, supra;* 12 Cal. Jur. 724-725; Restatement of Torts, §526.) *In whatever fashion scienter or knowledge on the part of the defendant is adduced from the evidence, it constitutes a vital element of plaintiff's cause of action, and must affirmatively appear in the findings to support a judgment for fraud. (Hoffman v. Kirby,* 136 Cal. 26, 29 [68 P. 321]; *Harding v. Robinson,* 175 Cal. 534, 539 [166 P. 808]; *Hall v. Mitchell,* 59 Cal.

App. 743, 748 [211 P. 853]. See, also, *Boas v. Bank of America,* 51 Cal. App. 2d 592, 599 [125 P. 2d 620].) (Emphasis supplied).

"In applying these rules to the finding which we have quoted, it becomes apparent that it is fatally deficient in its omission to find that defendant made the representation on which the judgment is founded either with knowledge of its falsity, or without a reasonable belief in its truth, or in a manner not warranted by the facts used as a basis for his statements. Although under certain circumstances one of the elements of fraud may be implied from certain other specific findings, as where the law may supply the intent to deceive from the fact that one has knowingly made false representations *(Boas v. Bank of American, supra,* p. 598) or where the materiality of a representation may be implied from the circumstances of plaintiff's reliance thereon *(Springer v. Angeles Credit Co.,* 44 Cal. App. 2d 712 [113 P. 2d 7]), *the mere finding that a representation of fact is false without a finding of the presence of the requisite element of scienter cannot sustain the conclusion of fraud in an action for damages based on deceit. (Hoffman v. Kirby, supra; Williams v. Spazier,* 134 Cal. App. 340, 345-348 [25 P. 2d 851], citing Civil Code §§1709, 1710.)" (Emphasis supplied.)

In *Hoffman v. Kirby,* 136 Cal. 26 [68 P. 321], cited in the *Wishnick* case, the facts were strikingly similar to those in the case at bar. In that case defendant represented to plaintiff that a certain tract of land in-

cluded two parcels consisting of approximately twenty acres. It subsequently developed that this acreage did not belong to the defendant. The complaint was for damages and alleged that plaintiff was induced to purchase the property by representations which defendant knew to be false, and which were made with the intent to deceive the plaintiff. As pointed out in the opinion of the Court at page 29 of 136 Cal., there was no finding that defendant knew the representations made by her were untrue, nor was there a finding that she had no reasonable ground for believing them to be true. The Court stated that in this state of the record

> ". . . the result is therefore the same as though the complaint were insufficient to show fraud or deceit."

The judgment in favor of plaintiff was reversed.

In *Gonsalves v. Hodgson,* 38 Cal. (2d) 91 [237 P. 2d 656], cited in *Wishnick v. Frye, supra,* at page 100 of 38 Cal. 2d, the Court says:

> "In an action for damages for deceit, the fraudulent representation relied upon must be as to a material fact which is false and known to be false by the maker, or is recklessly made or made without reasonable grounds for believing its truth. It must be made with intent to induce action by the other party and it must have been relied upon by the other party with justification. It must result in damage or injury to the party so relying. *The absence of any one of these elements will preclude recovery. (Barron Estate Co. v. Woodruff*

Co., 163 Cal. 561 [126 P. 351, 42 L.R.A.N.S. 125]; Civ. Code, §1709; 12 Cal. Jur. 724; Restatement of Torts, §525.)" (Emphasis ours.)

Thus, the rule is established that whether the defendant's fraud is based upon actual knowledge of the untruth of his statements, or upon the fact that they were made in a manner not warranted by his information, this knowledge or scienter, is a vital element of the plaintiff's cause of action, and must affirmatively appear in the findings to support a judgment for fraud. The absence of such a finding is fatal. Measured by this requirement, let us now examine the record.

Paragraph III of the second cause of action of the complaint (all references to the complaint are to the second cause of action thereof) alleges that defendants made the representations complained of. (Transcript of Record, p. 10). Paragraph IV alleges that the representations were false and fraudulent when made, and were either known to be false or fraudulent when made; or that they were made in a manner not warranted by defendants' information. (Transcript of Record, p. 11). Paragraph IX alleges the falsity of the representations. (Transcript of Record, p. 13). Paragraph X alleges that the defendants knew that the representations were false when made. (Transcript of Record, p. 14). Paragraph XI alleges that the defendants falsely and fraudulently represented the property to plaintiffs as being worth $38,000, when in truth and in fact it was worth not more than $18,000. (Transcript of Record, p. 14).

Knowledge or scienter on the part of defendants is therefore pleaded in paragraphs IV, X and XI, and issue was joined on these particular matters by the denials pleaded in paragraphs I, III and IV of the answer to the second cause of action. (Transcript of Record, p. 26). Passing for the moment the fact that there is no evidence in the record to support a finding that the representations were either made with knowledge of their falsity or in a manner not warranted by the information available to appellants (as will be presently pointed out), let us see if the trial court has anywhere made a finding that the representations were made either with knowledge of their falsity or in a manner not warranted by the information available to the defendants.

Paragraph III of the Findings of Fact (Transcript of Record, p. 50) alleges that it is true that the defendants made the representations as outlined in paragraph III of the complaint. Paragraph IV of the Findings of Fact (Transcript of Record, p. 53) alleges that it is not true that all of the improvements were on the property, and that it is true that the boundaries of the land were such as to leave one-third of the main residence, all of the carport, the guest house and a proportionate amount of the real property entirely off the defendants' land, and on Mulholland Drive, owned by the City of Los Angeles, and that it is untrue that the land as it actually existed was worth $38,000. Paragraph VI of the Findings of Fact (Transcript of Record, p. 53) also finds that it is true that one-third of

the main residence, the carport, guest house, the entrance driveway and other appurtenances were not included within the boundaries of the property. *There is no finding respecting the matters alleged in paragraphs IV, X and XI of the complaint.* The court made no finding either that appellants had actual knowledge of the untruth of the representations, or that they lacked an honest belief in their truth, or that they were carelessly and recklessly made in a manner not warranted by the information available to them. We are therefore governed by the rule as stated in *Wishnick v. Frye, supra,* at page 930, as follows:

> "In order to satisfy the requirement of scienter, it may be established either that defendant had actual knowledge of the untruth of his statements, or that he lacked an honest belief in their truth, or that the statements were carelessly and recklessly made, in a manner not warranted by the information available to defendant. *(Gonsalves v. Hodgson, supra*; 12 Cal. Jur. 724-725; Restatement of Torts, §526.) *In whatever fashion scienter or knowledge on the part of the defendant is adduced from the evidence, it constitutes a vital element of plaintiff's cause of action, and must affirmatively appear in the findings to support a judgment for fraud. (Hoffman v. Kirby,* 136 Cal. 26, 29 [68 P. 321]; *Harding v. Robinson,* 175 Cal. 534, 539 [166 P. 808]; *Hall v. Mitchell,* 59 Cal. App. 743, 748 [211 P. 853]. See, also, *Boas v. Bank of America,* 51 Cal. App. 2d 592, 599 [125 P. 2d 620].)
>
> *"In applying these rules to the finding which we have quoted, it becomes apparent that it is fatally*

deficient in its omission to find that defendant made the representation on which the judgment is founded either with knowledge of its falsity, or without a reasonable belief in its truth, or in a manner not warranted by the facts used as a basis for his statements." (Emphasis supplied.)

And as stated in *Hoffman v. Kirby, supra,* at page 29 in the absence of such findings "the result is therefore the same as though the complaint were insufficient to show fraud or deceit."

It is respectfully submitted that upon this ground alone, namely, that the Court failed to make a finding on the matter of scienter or knowledge on the part of appellants, that the judgment must be reversed.

II.

There Is No Evidence in the Record That Appellants Had Actual Knowledge of the Untruth of the Representations, or That They Were Made in a Manner Not Warranted by Their Information.

Upon the evidence in the record the trial court could not properly have found either that appellants had actual knowledge of the untruth of their statements, or that they lacked an honest belief in their truth, or that the statements were carelessly and recklessly made, in a manner not warranted by the information available to them.

There is no evidence in the record, and we are confident that appellees will not contend otherwise, that

appellants had actual knowledge of the fact that a portion of the main residence, the carport, guest house, cesspool and septic tank, and portions of the walks and driveways and of the landscaping and other appurtenances were not included within the boundaries of the property sold. The judgment can therefore not be sustained unless there is evidence that the representations made by appellants concerning the boundaries and the location of the improvements thereon were carelessly and recklessly made in a manner not warranted by their information. (*Wishnick v. Frye, supra;* C. C. 1710, subdivision 2; C. C. 1572, subdivision 2). But even this contention can not be sustained. On the contrary, the only evidence in the record is that appellants were told by Keith Daniels, at the time they purchased the property from him, that the improvements were within the boundaries of the property, that they believed this and had no information to the contrary. This was elicited by the questions put to Mr. Stone by Judge Harrison as follows:

Transcript of Record, page 132:

"THE COURT: When did you buy this property?

"THE WITNESS: September 15, 1952, I believe it was 1952.

"THE COURT: And when you bought it you assumed that all the improvements were on the property or the land that you have bought, didn't you?

"THE WITNESS: I certainly did.

"THE COURT: And that was the same land and same improvements that you sold to the Farnells?

"THE WITNESS: With the exception of some improvements, additional improvements.

"THE COURT: I mean as far as the property was concerned. Somebody sold it to you and you assumed that all the improvements were on the land?

"THE WITNESS: That is correct.

"THE COURT: And that is the way you sold it?

"THE WITNESS: That is correct, your Honor.

"THE COURT: And you also treated all the improvements as if they were on your land?

"THE WITNESS: I certainly did."

We find a close parallel in *Williams v. Spazier,* 134 Cal. App. 340 [25 Pac. 2d 851]. In that case defendants sold fifty shares of stock to plaintiff for $5,000 and in connection with the sale made certain representations as to the value of the stock and the plant of the company, all of which were untrue. Plaintiff sued to recover as damages the sum of $5,000 paid for the stock. The trial court found that the representations were made by defendant positively as statements of fact, that when made they were known by him to be false, and that at the time he had no information upon the subject of said representations sufficient to warrant the making thereof (page 343). The evidence showed that the parties were dealing at arm's length,

that the information given by defendant to plaintiff had been obtained by him from the person from whom he had previously purchased the stock, that he had been deceived by Warren (the person from whom he purchased the stock), and did not know that he had been deceived until long after the transaction with plaintiff was completed. There was no proof that defendant had any knowledge of the value of the stock other than the information which had been given him by Warren, and which he passed on to plaintiff.

The court states that deceit, as defined by C. C. 1709 and 1710, is "(1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true; (2) the assertion, as a fact, of that which is not true by one who has no reasonable ground for believing it to be true; . . ." At page 346 the court points out that the finding of the court was that the representations made by defendants were false when made, known to be false and without any foundation in fact, and made as statements of fact when defendants at the time had no information upon the subject of said representations sufficient to warrant the making therof. The court states:

> "It will be noted that it is nowhere found that appellant did not have reasonable grounds for believing the statements to be true."

The court further states:

> "The importance of this finding lies in the fact that there is not a word of evidence supporting the

first part of the finding—that the appellant knew the statements were false when he made these representations to the respondent. The undisputed and uncontradicted evidence is that the appellant was deceived by Warren, that he first consulted his banker and was given a favorable report of Warren and of the title company, that the statements which he made to the respondents were based on information given him by Warren, that he purchased from Warren stock in the company of like amount and at the same price as the respondents paid, and that he did not discover the falsity of Warren's representations until long after the transactions herein were completed. The case must rest, therefore, upon the second portion of the finding covering appellant's lack of information. As to this point the evidence is that appellant believed Warren after the recommendation of his banker and that he made no investigation of and had no information upon the financial standing of the title company other than what he had received from Warren. Now, whether these facts were sufficient to warrant the making of the statements or whether they formed reasonable ground for appellant's believing the representations to be true presents two entirely different lines of inquiry. What may be necessary to warrant the making of a statement depends upon all the circumstances under which the statement is made—the confidential or fiduciary relation between the parties, the mental capacity and business acumen of those to whom the statements are made, and the knowledge on the part of the maker as to the manner in which they will be received—whether with or without investi-

gation on the part of those to whom the statements are made. But whether a party has a reasonable ground for believing a statement to be true depends wholly upon the conditions under which he has formed that belief. Thus the fact depends upon the conditions existing prior to the making of the statement and does not depend, as in the other case, upon the circumstances under which, or the parties to whom, it is made. *Hence if the appellant believed these statements to be true, and the evidence shows that he did so believe, then the inquiry is, did he lack reasonable ground for believing them? Upon this issue there was no finding . . . there is no evidence that said misstatements were made (1) wilfully, (2) with intent to deceive, (3) that he did not believe them to be true, or (4) that he had no reasonable ground for believing them to be true. The respondents were bound to introduce proof not merely of a falsehood but of falsehood and fraud or deceit.*" (Emphasis supplied.)

The judgment was reversed.

As stated in *Williams v. Spazier, supra,* the evidence shows unmistakably that appellants were deceived by their vendor, Keith Daniels; that they did not know that the statements were untrue at the time they were made, and that they simply passed along to appellees the information which they had obtained from their vendor. Upon this state of the record it is respectfully submitted that if a finding on the issue of knowledge had been made by the trial court, that it could only have been that the appellants had no knowledge of

the falsity of the representations, that they believed the representations to be true, and that they had reasonable grounds for believing them to be true.

Further bearing on the question of whether or not appellants lacked an honest belief in the truth of the statements made by them, we call the Court's attention to the fact that as part of the consideration for the sale of the property, appellants took back a promissory note secured by a second deed of trust in the sum of $11,166.36. (Exhibits "A" and "B" attached to the complaint, Transcript of Record, pps. 32 to 34; Findings of Fact, paragraph III 4 (5), Transcript of Record, p. 52). This was almost 30% of the total purchase price. Surely, if appellants knew or had any reason to suspect that a substantial part of the improvements were not on the property which they were selling it is inconceivable that they would have taken back a second deed of trust in such a substantial amount on such doubtful security.

There is still another circumstance which demonstrates that appellants honestly believed that the representations made by them concerning the location of the improvements and the boundaries of the property were true. Prior to the sale to appellees, the house was about 80% damaged by fire. Appellants received $15,100 in insurance and spent in excess of $26,000 in rebuilding the house. It was rebuilt on the same foundation. (Transcript of Record, p. 132). Certainly if appellants knew or had any reason to suspect that any part of the house was on city property, they would not have rebuilt it

on property they did not own. If they had had this knowledge, it is reasonable to assume that they would have taken the insurance money and rebuilt the house in such a manner that it would be entirely within the confines of their own property, and would not have spent $26,000 in rebuilding it on the old foundation so that about 1/3 of it was on city property.

As to the effect of reasonable ground for belief in the truth of the statements, the rule is stated in *1 Black on Rescission and Cancellation,* 319, §107, as follows:

> "In several of the states where the substantive law has been codified, the statutes declare that 'actual fraud' may be committed by 'the positive assertion in a manner not warranted by the information of the party making it, of that which is not true, though he believes it to be true,' and that 'deceit' shall include, among other things, 'the assertion as a fact of that which is not true, by one who has no reasonable ground for believing it to be true.' (Reference is made in the text to Sections 1572 and 1710 of the California Civil Code). Under these statutes, therefore, a positive representation which is actually untrue has exactly the same effect, when the person making it has no reasonable ground for believing it to be true, as when he knows it to be false. And on the other hand, if the person making the representation believes it to be true, and has reasonable grounds for so believing, there is no actionable fraud committed, however false it may actually be."

Again at page 321, §108, the writer states:

> "In an action at law of deceit or to recover damages for fraudulent misrepresentations, or where such misrepresentations are set up in defense to an action on a contract, it is necessary to allege and show an intention to deceive, or to defraud by means of a deception, and the action can not be sustained, or the defense prevail, if it appears that the representations were made innocently and in good faith, without any intention to deceive . . ."

Many cases are cited in support of the text, including *Hodgkins v. Dunham,* 10 Cal. App. 690 [103 Pac. 351]. This was an action for damages for fraudulent representations made by defendant in connection with a sale to plaintiff. At page 706 of 10 Cal. App., the Court states:

> "Were the representations actually believed by defendants on reasonable grounds to be true? If so, the rule exonerates them."

The effect of an honest belief is stated in *37 Corpus Juris Secundum,* 263, §24, as follows:

> "As a general rule, a misrepresentation made through honest error and with a bona fide belief in its truth is not fraudulent."

Many California cases are cited in the text. Among these are the following:

Meeker vs. Cross, 59 Cal. App. 512 [211 Pac. 229]. At page 518 of 59 Cal. App., the Court states:

"Neither, in our opinion, is the evidence sufficient to justify the finding made by the court that the representation made by defendant was a 'positive assertion made in a manner not warranted by the information of the defendant making it,' which, if sustained by the evidence, would bring the case within the second subdivision of section 1572 of the Civil Code, which declares actual fraud to consist of 'the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true.' What we have heretofore said is likewise applicable to this phase of the case. *While the representation was concededly untrue, nevertheless the information which the defendant had with reference to the condition of the company and upon which he based the representation, justified him in believing it to be true and was warranted by the information which he had upon the subject.*" (Emphasis supplied).

Judgment for plaintiff was reversed.

Bartlett v. Suburban Estates, Inc., 12 Cal. 2d 527 [86 Pac. 2d 117]. At page 530 of 12 Cal. 2d, the Court states:

"But where the seller acted upon information sufficient to justify a reasonable man in concluding that no permit was required, then he is not liable in fraud even though he was mistaken in his belief.

"Therefore, insofar as the liability of the defendants in these actions is concerned, . . . the plaintiffs cannot recover if the defendants acted

upon information sufficient to justify a reasonable man in believing that a permit was not required."

This decision involved eight consolidated cases. Judgment of the trial court for plaintiffs in each was reversed.

Nunemacher v. Western Motor Transport Company, 82 Cal. App. 233 [255 Pac. 266]. At page 239 of 82 Cal. App., the Court states:

"It is true that 'the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true,' constitutes actual fraud. (Civ. Code, sec. 1572, subd. 2.) But in this case it reasonably appears that the representation in question was warranted by the information contained in the report of June 20th and the fact that the volume of business was steadily increasing. 'Where a man makes a representation in the reasonable belief that it is true, fraud will not be imputed to him if it afterward be shown to be untrue, but there must be reasonable grounds for his belief.' *(Maxson v. Llewelyn,* 122 Cal. 195, 198 [54 Pac. 732];*Otis v. Zeiss,* 175 Cal. 192, 194 [165 Pac. 524]; *Nash v. Rosesteel,* 7 Cal. App. 504, 509 [94 Pac. 850]; *Hodgkins v. Dunham,* 10 Cal. App. 690 706 [103 Pac. 351]; *Meeker v. Cross,* 59 Cal. App. 512, 516 [211 Pac. 229].) The court found that 'any and all representations or statements made by defendant to plaintiff at said time were made in the belief by defendant that same were true in each and every particular, and said belief that same were true in each and every particular was fully

> justified by the facts and circumstances as they existed and were known to defendant at the time such representations or statements were made.' This finding is fully supported by the evidence."

The judgment awarding plaintiff damages was reversed.

Other cases to the same effect are *Brown v. Harper,* 116 Cal. App. 2d 48, 53 [253 Pac. 2nd 95]; *Cox v. Westling,* 96 Cal. App. 2d 225, 229 [215 Pac. 2d 52]; *McElligott v. Freeland,* 139 Cal. App. 143, 154 [33 Pac. 2d 430]. In the case last cited at page 154 of 139 Cal. App., the Court states:

> "Appellants further contend that, if it be assumed that the various representations specified in the findings were made and that they were false statements of fact, nevertheless the evidence wholly fails to support the trial court's finding that they were made knowingly. In other words, it is contended that proof of scienter was wholly lacking. It is a primary rule of the law of fraud that to warrant recovery for fraudulent representations it must appear that the party sought to be charged knew that the statements which he made were false."

To the same effect is *Walker v. Dept. of Public Works,* 108 C. A. 508 [291 Pac. 907]. At page 519 of 108 C. A. the Court states:

> "At least it seems quite evident that these representatives of the appellant had no knowledge or reason to believe their statements were untrue. The evidence is therefore insufficient to support a judgment based upon fraud."

Judgment for plaintiff was reversed.

And in *Daley v. Quick,* 99 Cal. 179 [33 Pac. 859], at page 185 of 99 Cal.:

> " 'A deceit within the meaning of this section (C. C. 1709) is defined as 'the suggestion as a fact of that which is not true, by one who does not believe it to be true.' If this be the ground relied upon, the evidence is wholly insufficient to show, taking the representations to have been false, that the person making them did not believe them to be true. 'The assertion as a fact of that which is not true by one who has no reasonable ground in believing it to be true,' is also a sufficient deception to have an action upon. But in this case there is no evidence tending to show that the person making the representations had no reasonable ground for believing them to be true.' "

When appellants purchased the property from Keith Daniels he gave them a map or sketch which showed that two feet of the carport encroached on Mulholland Drive, but that all of the other improvements were on the property. They had no other information regarding the south boundary line. (Transcript of Record, pp. 137 and 138). They assumed that the map was true and correct, (Transcript of Record, p. 141), and that all of the improvements were on their property. (Transcript of Record, p. 133).

This was sufficient basis for their belief that the representations made by them were true.

> *Nathanson v. Murphy,* 132 Cal. App. 2d 363, 367 [282 Pac. 2d 174].

The rule exonerating one from liability for damages by reason of a misrepresentation made through honest error, and with a bona fide belief in its truth is the general rule and the great weight of authority. *Corpus Juris Secundum* recognizes that in a minority of jurisdictions scienter, knowledge of falsity, are not essential elements of actionable fraud, and that in these jurisdictions a misrepresentation may be actionable even though made innocently and honestly believed to be true. (*37 Corpus Juris Secundum* 265, §25). It is significant to note, however, that while many of the decisions previously referred to are cited in support of the majority rule, that no California cases are cited in support of the minority position. That California follows the majority rule, requiring proof of scienter, is established in *Wishnick v. Frye, supra.* As stated at page 931 of 111 Cal. App. 2d:

> "Plaintiff erroneously argues that scienter is an 'inconvenient requirement' which has been dispensed with in eight American jurisdictions as an element of actionable fraud. However, this view is supported only by a minority of jurisdictions, while the courts of this state continue to adhere to the majority rule. (See 37 C.J.S. 265.)"

III.

Although Honest Belief or Lack of Knowledge Is Not a Defense in an Action for Rescission Based on Fraud, a Different Rule Applies in an Action for Damages. Authorities Involving Actions in Rescission Are Therefore Not in Point.

At this point a distinction should also be noted between the proof necessary in an action at law for damages based on fraud, and an action in equity for rescission. Although a party induced by fraud to enter into a contract may elect either to affirm and sue for damages, or disaffirm and seek rescission or other relief in equity, the proof required in both cases is not the same. It is well established that the elements essential to support an action for damages for fraud or deceit are sufficient to support an action based on rescission. However, the converse of the rule that what amounts to fraud in law constitutes fraud in equity is not in all instances true. As stated in *37 Corpus Juris Secundum* 219, §4:

> " . . . while an innocent representation may be insufficient to sustain a tort action for deceit it may be sufficient to sustain an action for rescission or for general equitable relief."

The same distinction is recognized in *1 Black Rescission and Cancellation* 320, §107. In speaking of actions at law for fraud and deceit, the Court states:

> "And conversely, if the circumstances are such as to justify a belief in the truth of the statement made, it is not fraudulent, although false.

"But while this test may be fairly satisfactory in an action of deceit or an action to recover damages for alleged fraud, it has been considered inappropriate when the relief sought is the rescission of a contract or other obligation. To establish the fact that the party making a representation believed it to be true, and had reasonable grounds for his belief, will prove his sincerity, and so eliminate from the case that element of turpitude or sinister design which lies at the base of any action of tort. But one who relies upon a false representation, and is injured thereby, is in exactly the same position whether the party making the representation was sincere or insincere. There may not have been such conscious fraud as would lay a foundation for the recovery of damages; yet it does not follow that the injured party should not be entitled to rescind."

This distinction is recognized in *Wishnick v. Frye, supra,* 111 Cal. App. 2d 926 [245 Pac. 2d 532]. As previously stated, this was an action at law to recover damages for fraud and deceit. Plaintiff recovered judgment and was reversed on appeal upon the ground that there was no finding by the court of scienter or knowledge on the part of the defendant, without which the conclusion of fraud in an action for damages based on deceit could not be sustained. At page 931 of 111 Cal. App. 2d, the court states:

"Plaintiff earnestly argues that scienter is an 'inconvenient requirement' which has been dispensed with in eight American jurisdictions as an element of actionable fraud. However, this view is supported only by a minority of jurisdictions,

while the courts of this state continue to adhere to the majority rule. (See 37 C.J.S. 265.) Plaintiff cites a number of California decisions which he asserts show a tendency to depart from the rule requiring scienter. An analysis of these cases discloses that they do not support plaintiff's contention. A group of these cases involves rescission of land sales contracts by a vendee who was induced to purchase because of representations made by the vendor which were not warranted by the information available to him (*Scott v. Delta Land & W. Co.,* 57 Cal. App. 320 [207 P. 389]; *Muller v. Palmer,* 144 Cal. 305 [77 P. 954]; *Edwards v. Sergi,* 137 Cal. App. 369 [30 P. 2d 541]), or where rescission was granted the vendee on the theory that a vendor of land is presumed to know his own boundaries. (*Lombardi v. Sinanides,* 71 Cal. App. 272 [235 P. 455]; *Del Grande v. Castelhun,* 56 Cal. App. 366 [205 P. 18].) In all of these cases the findings fully supported the complaint of fraud. Plaintiff refers us to only two cases involving deceit actions, but neither is authority for his position. In *Gaffney v. Graf,* 73 Cal. App. 622 [238 P. 1054], the court found that defendant's positive statements of fact to a purchaser were made without sufficient information on which to base a reasonable belief in their truth. In *MacDonald v. de Fremery,* 168 Cal. 189 [142 P. 73], a judgment in a deceit action in favor of defendants was reversed, partly for the reason that the evidence revealed that defendants must have known of the falsity of their statements."

The Federal Courts also recognize this distinction and follow the majority rule. In *Woods-Faulkner &*

Co. v. Michelson, 63 Fed. (2) 569, [C.C.A., 8th Cir. Feb. 17, 1933], the action was brought for rescission of a stock purchase transaction based upon false and fraudulent representations. The Court recognizes the distinction between an action in equity for *rescission* and one at law for damages, insofar as the question of scienter is concerned. At page 572:

> "This is a suit in equity to rescind a contract, and not an action at law for damages on account of fraud and deceit. . . . The distinction between the two remedies is pointed out by this court in *Kimber v. Young,* 137 F. 744, 747, where it is said: '*The basis of the action of deceit is the actual fraud of defendant—his moral delinquency; and therefore his knowledge of the falsity of the representation, or that which in law is equivalent thereto, must be averred and proved.* There is much confusion in the authorities upon this subject, due in part to the erroneous assumption that that which is merely evidence of fraud is equivalent to the ultimate fact which it tends to prove, and also to the assumption, likewise erroneous, that an untrue representation which would be sufficient to support a suit in equity for a rescission of a contract is equally as available in an action of deceit.'
>
> "While the elements essential to sustain an action at law for fraud and deceit are sufficient to sustain a suit in equity for rescission of the contract of sale, the converse of this statement is not true. Even an innocent misrepresentation is sufficient to sustain an action to rescind, while, *to sustain an action for damages for fraud and deceit,*

the representation must have been actually fraudulent, involving moral delinquency." (Emphasis supplied.)

IV.

The Conclusion of Law That Plaintiffs Are Entitled to Judgment in the Sum of $15,000 Is Not Supported By the Findings of Fact.

The measure of damages in cases of fraud arising out of the sale of real property is laid down by *Section 3343* of the Civil Code of the State of California, and is what is known as the "out of pocket" rule. Under this rule plaintiffs can recover only the difference between the price paid for the property and the value of the property which they received. This is established by the recent case of *Bagdasarian v. Gragnon,* 31 Cal. 2d 744 [192 P. 2d 935]. The "out of pocket" rule is followed in the Federal Court. *Bagdasarian v. Gragnon, supra,* page 759, citing *McCormick on Damages* (1935), 448-454; 24 Am. Jur. 58-62; (1939) 13 So. Cal. Law Rev. 168-170.

In order to support the judgment in favor of appellees for damages there must be a finding, first, of the price paid for the property, and second, a finding of the value of the property received by them. Paragraph V of the Findings of Fact recites that appellees gave to appellants the contractual consideration, which, as stated in paragraph III, subparagraph 4 (1), was $38,000. *However, there is no finding of the value of the land and improvements received by appellees.* The

failure of the court to find on this material issue is prejudicial error. *Baydasarian v. Graynon, supra,* page 763.

Nor is this defect cured by the last sentence in paragraph VI of the Findings of Fact that "it is untrue that defendants' land as it actually existed was worth $38,000.00." This is clearly a negative pregnant and is an admission that the property was worth any sum less than $38,000, to-wit: $37,999. To support the conclusion of the law that plaintiffs are entitled to judgment in the sum of $15,000, and the judgment in that amount, there must have been a finding that the property received by them was worth $23,000 and no more. This is not the effect of the finding as contained in paragraph IV that it is untrue that the land was worth $38,000. It is just as logical under the finding as made to say that the land was worth $37,999, as it is to contend that it was worth only $23,000.

As stated in *24 Cal. Jur.* 976, §208:

> "A finding in the form of a negative pregnant, attempting to negative an affirmative allegation, implies the truth of such allegation."

Cases involving the insufficiency of pleadings in the form of a negative pregnant are analogous. Typical of these are the following:

Janeway & Carpender v. Long Beach Paper & Paint Co., 190 Cal. 150 [21 Pac. 6]. At page 153 of 190 Cal.:

The denial of nonpayment of $6,190.88 was in the following form:

> Defendant ". . . denies that the said sum of $6,190.88 has not been paid."

The Court said:

> "This is an admission that the sum of $6,190.87 is unpaid. . . ."

Beetson v. Hollywood Athletic Club, 109 C. A. 715 [293 Pac. 821]:

Plaintiff alleged damage to his automobile in the sum of $254.19. Defendant denied "that said automobile was damaged . . . in the sum of Two Hundred Fifty-four and 19/100 Dollars ($254.19)."

The Court, at page 723 of 109 C. A., said:

> "By thus answering in the form of a negative pregnant, defendant admitted that the damage to said automobile was any sum less than $254.19, to-wit: $254.18."

Armer v. Dorton, 50 C. A. 2d 413 [123 Pac. 2d 94]:

Plaintiff alleged that the reasonable value of the use of his automobile was $105.00. The denial was in the form of a negative pregnant. The Court, at page 415 of 50 C. A. 2d, said:

> "Under the authorities it must be held that a denial in such form is a negative pregnant, so far as the value of the loss of use is concerned, and that appellants' answer must be taken as an admission that the reasonable value of the loss of use was

any sum less than $105. In the case of *Preston v. Central Cal. etc. Irr. Dist.,* 11 Cal. App. 190 [104 Pac. 462], the court said:

" 'The answer . . . is as follows: 'Said defendant denies that the defendant became justly or otherwise indebted to B. E. Hooper . . . between the first day of March, 1907, and the first day of September, 1907, or any other time, in the sum of four hundred and thirteen and 56/100 dollars.'

" 'It is at once apparent that the foregoing denial involves a negative pregnant, the denial being in the precise sum alleged in that count of the complaint, and, therefore, an admission of an indebtedness of any lesser amount. (*Blankman v. Vallejo,* 15 Cal. 638; *Towdy v. Ellis,* 22 Cal. 650; *Estee's Pleadings,* sec. 3174.)'

"In *Connecticut Mutual Life Insurance Co. v. Most,* 39 Cal. App. (2d) 634 [103 Pac. (2d) 1013], where the answer of defendant merely denied that the specific amount alleged in plaintiff's complaint to be due was due, the court said at page 640:

" 'Under proper rules of pleading the allegations might be construed as an admission that all but a single dollar of the amount claimed due was actually due and payable. The allegation of the answer, containing as it does a negative pregnant, was evasive and wholly insufficient to raise the issue of payment. (*Blankman et al. v. Vallejo,* 15 Cal. 639, 645; *Masters v. Lash,* 61 Cal. 622, 624; *Westbay v. Gray,* 116 Cal. 660, 663 [48 Pac. 800]; *Provident Gold Min. Co. v. Haynes,* 173 Cal. 44, 48 [159 Pac. 155]; *Janeway & Carpender v. Long Beach Co.,* 190 Cal. 150, 153 [211 Pac. 6]; *Motor Investment Co. v. Breslauer,* 64 Cal. App. 230, 240 [221 Pac. 700].)' "

Schroeder v. Mauzy, 16 C.A. 443 [118 Pac. 459]: Plaintiff's piano was destroyed by fire while in defendant's possession. Plaintiff sued to recover its value, which he alleged to be $1000.00, defendant having failed to insure it as agreed. At page 446 of 16 C.A. the court said:

> "The answer of the defendant denied that he had caused the piano to be insured for plaintiff's benefit or at all, and by specific denials put in issue every other material allegation of the plaintiff's complaint, save and except the allegation of the loss and the value of the piano.
>
> "The defendant's attempted denial of the alleged value of the piano, in the form of a negative pregnant, was not a denial of the allegation in the complaint, but was an admission that the piano, at the time specified in the complaint, was of the value of any sum less than $1,000, and raised no issue upon the subject of value as pleaded by plaintiff. (*Leffingwell v. Griffing,* 31 Cal. 232; *Scovill v. Barney,* 4 Or. 288.)"

Kennedy v. Rosecrans Gardens, Inc., 114 C.A. (2d) 87 [249 Pac. (2nd) 593]: At page 89 of 114 C.A. (2d), the court said:

> "Plaintiff alleged in paragraph VII of his complaint he had been damaged in the sum of $3,500. Defendant denied 'each and every allegation' of paragraph VII. The court found the allegations of paragraph VII to be untrue but made no other findings as to damage. The answer was merely a denial that plaintiff had suffered damage in the amount of $3,500 and was an admission that he had suffered substantial damage."

The finding with respect to damages is defective in still another particular. As appears from Exhibit "A" attached to the complaint (Transcript of Record, pages 17 and 18), included in the purchase price of $38,000 was the furniture in the guest house. The appraiser P. B. Baehr testified as follows:

> "My market value of the property as it appeared to exist was not $38,000. There was personal property involved which cut the value down." (Transcript of Record, p. 79).

He was not asked and he did not testify as to the value of the personal property. Nor did the Court make any finding as to the value of the personal property. We find the same situation in *Bagdasarian v. Gragnon, supra,* where the court failed to make a finding as to the value of certain farm equipment which was included as part of the total consideration paid by the plaintif. At page 763, the court states:

> "Since the items of the transaction were not severable, the sum paid for the farm equipment must be included as a part of the total consideration given by respondents and the actual value of the farm equipment must be included as a part of the value of the property received by respondent. . . . *No finding was made, however, as to the value of this property, and the failure to determine the amount and to include it in computing the value of the property received constituted prejudicial error.*" (Emphasis supplied)

So in the instant case, the furniture in the guest house was obviously included as part of the total consideration given by appellants. The escrow instructions, Exhibit "A" attached to the complaint (Transcript of Record, p. 18) state that the furniture in the guest house is to be delivered at close of escrow without additional consideration. In determining the amount of appellees' "out of pocket" loss, to which they are limited by the provisions of Section 3343 of the Civil Code, no claim being made that any misrepresentations were made concerning the furniture, appellants were entitled to credit for the reasonable market value of the furniture. As stated in *Bagdasarian v. Gragnon,* no finding was made as to value of this property and the failure to determine the value thereof, and to include it in computing the value of the property actually received by appellees, constituted prejudicial error.

V.

Paragraph V of the Court's Findings of Fact, That It Is True That Plaintiffs Relied Upon Plaintiffs' (sic) Representation, Is Not Supported by the Evidence.

A literal reading of this finding is that plaintiffs relied upon their own representations in purchasing the property. However, we will assume that it was intended to state that plaintiffs relied upon defendants' representations, and not upon their own, and will discuss this finding as though it read as follows:

> "It is true that plaintiffs relied upon defendants' representation . . . "

As stated in *Gonsalves v. Hodgson,* 38 Cal. 2d 91 [237 P. 2d 656], at page 100 of 38 Cal. 2d:

> "In an action for damages for deceit, the fraudulent representation relied upon must be as to a material fact which is false and known to be false by the maker, or is recklessly made or made without reasonable grounds for believing its truth. It must be made with intent to induce action by the other party and *it must have been relied upon by the other party with justification.* It must result in damage or injury to the party so relying. *The absence of any one of these elements will preclude recovery."* (Emphasis supplied).

As stated in *23 Cal. Jur.* 2d 95, §39:

> "Inasmuch as notice of facts and circumstances which would put an ordinarily prudent and intelligent person on inquiry is in the eye of the law

> equivalent to knowledge of all of the facts that a reasonably diligent inquiry would disclose, it is an established principal that though one in the original instance may have been justified in relying on representations, still when, thereafter, he discovers that he has been deceived and defrauded as to one material matter, he has notice that he may have been defrauded as to other matters, and is bound to make a full investigation."

We direct the Court's attention to the fact that Mrs. Stone testified that she had a conversation with Mrs. Farnell on the property prior to the sale; that she had a sketch or map with her which had been given to her by Keith Daniels, the former owner; and that this map or sketch showed that two feet of the carport encroached on Mulholland Drive, but that everything else was within the boundary lines of the property. She testified further that she told Mrs. Farnell that two feet of the carport was on city property; that she had obtained the map from Mr. Daniels, the former owner, and that she gave it to Mrs. Farnell. (Transcript of Record, pp. 137 and 138). The Farnells said nothing and made no protest. (Transcript of Record, p. 142). *Mrs. Farnell did not deny any part of this testimony.* It should be pointed out that this conversation was between Mrs. Stone and Mrs. Farnell. Mrs. Stone testified that Mr. Farnell was not present. (Transcript of Record, p. 137). This was not the conversation between Mr. Farnell and Mrs. Stone concerning which Mrs. Farnell testified. (Transcript of Record, pp. 128 and 129).

It is therefore established without contradiction that prior to the consummation of the sale, Mrs. Farnell was told that two feet of the carport encroached on city property, and that she was given a map or sketch showing this to be the case. Under such circumstances, it became the duty of the purchasers to make a complete investigation. (*23 Cal. Jur.* 2d 95, §39), and appellees were not entitled to rely upon the representations made by the sellers.

As stated in *Carpenter v. Hamilton,* 18 Cal. App. 2d, 69 [62 Pac. 2d 1397], at page 75 of 18 Cal. App. 2d:

> "The rule is universally recognized in fraud cases that where the buyer is aware of suspicious circumstances or has learned of the falsity of one or more of the representations he is under a legal duty to make a complete investigation and may not rely upon the statements of the seller. (*Gratz v. Schuler, supra; 12 Cal. Jur.,* sec. 37, p. 763.) Plaintiffs were not dissuaded from making a complete investigation by any artifice of defendant and they therefore cannot complain of conditions which they would have discovered if they had pursued their investigations to the end.
>
> "Plaintiffs' testimony that they relied upon the representations cannot stand against the other evidence from which they must be held to have had knowledge of their falsity. Courts cannot be expected to extricate persons from entanglements into which they have fallen through their own neglect of duty. The rule which applies in the case of actual knowledge of the facts has equal application where the facts would have been ascertained

in the performance of a duty to use ordinary care.

"For each of the reasons stated the evidence was insufficient to support a recovery based on fraud."

A leading case in California is *Hobart v. Hobart Estate Co.,* 26 Cal. 2d 412 [159 Pac. 2d 958]. This case cites and quotes from many of the earlier California cases, and we will therefore quote at length from the decision of the court commencing at page 437 of 26 Cal. 2d:

> "Section 19 of the Civil Code provides: 'Every person who has actual notice of circumstances *sufficient to put a prudent man upon inquiry* as to a particular fact, has constructive notice of the fact itself in all cases in which, by prosecuting such inquiry, he might have learned such fact.' (Italics added.) . . . *The circumstances must be such that the inquiry becomes a duty, and the failure to make it a negligent omission.'* (Italics added.) Many other decisions have adopted this view. (See *Mary Pickford Co. v. Bayly Bros., Inc.,* 12 Cal. 2d 501, 511 [86 P. 2d 102]; *Original Min. & Mill. Co. v. Casad,* 210 Cal. 71, 76 [290 P. 456]; *Prewitt v. Sunnymead Orchard Co.,* 189 Cal. 723, 730 [209 P. 995]; *Victor Oil Co. v. Drum,* 184 Cal. 226, 241 [193 P. 243]; *Lady Washington C. Co. v. Wood,* 113 Cal. 482 [45 P. 809]; *West v. Great Western Power Co.,* 36 Cal. App. 2d 403, 406, et seq. [97 P. 2d 1014]; *Denson v. Pressey,* 13 Cal. App. 2d 472 [57 P. 2d 522]; *Edwards v. Sergi,* 137 Cal. App. 369 [30 P. 2d 541]; cf. *Smith v. Martin,* 135 Cal. 247, 254-255 [67 P. 779].) In many cases it has

been said that means of knowledge are equivalent to knowledge. (See *Shain v. Sresovich,* 104 Cal. 402, 405 [38 P. 51]; *People v. San Joaquin etc. Assn.,* 151 Cal. 797, 807 [91 P. 740]; *Consolidated R. & P. Co. v. Scarborough,* 216 Cal. 698, 701, et seq. [16 P. 2d 268]; *Knapp v. Knapp,* 15 Cal. 2d 237, 242 [100 P. 2d 759]; *Bainbridge v. Stoner,* 16 Cal. 2d 423, 430 [106 P. 2d 423]; *Merrill v. Los Angeles Cotton Mills, Inc.,* 120 Cal. App. 149, 158 [7 P. 2d 329]; *Daily Tel. Co. v. Long Beach Press Pub. Co.,* 133 Cal. App. 140, 143-147 [23 P. 2d 833]; *Wheaton v. Nolan,* 3 Cal. App. 2d 401, 403 [39 P. 2d 457]; *Haley v. Santa Fe Land Imp. Co.,* 5 Cal. App. 2d 415, 420, 423 [42 P. 2d 1078]; *Vertex Inv. Co. v. Schwabacher,* 57 Cal. App. 2d 406, 415-418 [134 P. 2d 891]; *Bryan v. Nicolas,* 67 Cal. App. 2d 898 [155 P. 2d 835]; cf. *Truet v. Onderdonk,* 120 Cal. 581, 589 [53 P. 26]; *Phelps v. Grady,* 168 Cal. 73, 79-80 [141 P. 926]; *Malone v. Clise,* 18 Cal. App. 2d 154, 157 [63 P. 2d 321].) This is true, however, only where there is a duty to inquire, as where plaintiff is aware of facts which would make a reasonably prudent person suspicious. In the *Lady Washington case,* the court said (113 Cal. at p. 487) that 'as the means of knowledge are equivalent to knowledge, *if it appears that the plaintiff had notice or information of circumstances which would put him on an inquiry* which, if followed, would lead to knowledge, or that the facts were presumptively within his knowledge, he will be deemed to have had actual knowledge of these facts.' "

Knowledge of the fact that two feet of the carport encroached on city property was sufficient to put ap-

pellees upon inquiry as to the true location of the boundary line and the improvements on the property. The means of discovery of the facts concerning the location of the boundary line were readily available to them. They had but to go to the City Engineer's office to obtain full information. This is what Mr. Farnell did after the sale. (Transcript of Record, pp. 118 and 119). If they had acted as reasonably prudent persons they would have made the same inquiry immediately after being told that two feet of the carport was on city property, and if they had done so, the mistake would have been discovered at that time. It was their legal duty to make such inquiry and not having done so, they had no right to rely on the statements made by appellants. *Hobart vs. Hobart Estate Co., supra.*

The maps and records in the City Engineer's office are matters of public record. As stated in *23 Cal. Jur.* 2d 156, §63:

> "Relief cannot be granted on the ground of fraud where it appears that the party seeking it, when the duty was incumbent on him to investigate, has, through his own negligence, failed to ascertain matters of public record. The rule is that one is presumed to know whatever he might, with reasonable diligence, have discovered; and when the facts on which the alleged fraud rests are matters of public record, open to inspection, ignorance of the fraud will not excuse him."

It is therefore respectfully submitted that the finding that appellees relied upon the representations made by appellants is entirely without factual or legal support.

VI.

The Evidence at Best Shows That Appellants Were Mistaken as to the Boundaries of the Property and the Location of the Improvements. An Allegation of Fraud Is Not Sustained by Proof of Mistake.

We direct the court's attention to the following colloquy between the court and counsel at page 59 of the Transcript of Record:

> "The Court: As I understand from the statements of counsel this property was sold by the seller to a purchaser and afterwards the property was surveyed and it was found that all the improvements were not on the property sold.
>
> Mr. Pollack: That is correct, Judge Harrison.
>
> The Court: There had been a mistake as to the boundaries.
>
> Mr. Cutler: That is so stipulated and that is the fact."

As the record will show, Mr. Pollack was the attorney for the appellants in the trial court, and Mr. Cutler was the attorney for appellees. It is clear from the statement of the court and the stipulation of counsel above quoted that a mistake existed as to the boundaries of the property. However, an allegation of fraud

is not sustained by proof of mistake. It was so held in *Mercier v. Lewis,* 39 Cal. 532. In that case the complaint charged defendants with fraud in conveying certain real property. At the trial plaintiff failed to prove the fraud as alleged. The court ordered judgment against the defendants based upon a mistake in the deed. At page 535 the court states:

> "It is apparent that the judgment is erroneous. *The plaintiff's allegation of actual fraud is not sustained by proof of the mistake."* (Emphasis supplied)

The judgment was reversed. *Mercier v. Lewis* is cited and the rule as above stated is approved in *Cardozo v. Bank of America,* 116 Cal. App. 2d 833, [254 Pac. 2d 949], at page 837 of 116 Cal. App. 2d.

It is respectfully submitted that the evidence in the record, including the stipulation of counsel, establishes nothing more than a mistake. This being so, the judgment based upon a conclusion of law that the appellants were guilty of fraud can not be sustained.

VII.

There Is No Finding of Fact on the Issue of Whether or Not the Representations Alleged To Have Been Made by Appellants Were False and Fraudulent as Alleged in Paragraphs IV, X and XI of the Complaint.

It is alleged in paragraph IV of the complaint that the statements and representations set forth in paragraph III were false and fraudulent and were known by appellants to be false and fraudulent when made. It is alleged in paragraph X that at the time of the sale appellants knew the facts alleged in paragraph IX, namely, that the boundary line of the property ran through the main residence, and that one-third of the main residence, the carport, guest house, cesspool and septic tank, and portions of the walks and driveways and of the landscaping and other appurtenances, were entirely off the property and on Mulholland Drive. It is alleged in paragraph XI that appellants falsely and fraudulently represented that the property was well worth the purchase price of $38,000. Issue was joined on each of these allegations and they were specifically denied by paragraphs I, III and IV of the answer to the second cause of action. (Transcript of Record, pp. 26 and 27).

Obviously fraud was the gist of the complaint and the issue tendered by the pleadings was as to whether or not the representations attributed to appellants were fraudulently made. It is elementary that the

parties to an action are entitled to findings of fact on all material issues. The general rule is stated in *24 Cal. Jur.* 935, §183, as follows:

> "Under the system of express findings now provided for, full findings, unless waived, are required on all material issues raised by the pleadings and evidence."

Three full pages of authorities are cited in support of the text. As the rule is fundamental we will refer the court to but a few of the many authorities cited and respectfully direct the court's attention to the following:

DeBurgh v. DeBurgh, 39 Cal. 2d 858 [250 Pac. 2d 598]. At page 873 of 39 Cal. 2d:

> "It is essential that findings be made on every material issue raised by the pleadings. (Citations)"

Commeford v. Baker, 127 Cal. App. 2d 111 [273 Pac. 2d 321]. At page 120 of 127 Cal. App. 2d:

> "It is a settled rule of appellate procedure that *a judgment may not stand in the absence of findings on the material issues which support the judgment."* (Emphasis supplied)

Andrews v. Cunningham, 105 Cal. App. 2d 525 [233 Pac. 2d 563]. At page 528 of 105 Cal. App. 2d:

> "It is elementary law, recently reiterated in *Fairchild v. Raines,* 24 Cal. 2d 818, 830 [151 P. 2d 260] that: 'Ever since the adoption of the codes, it has been the rule that findings are re-

quired on all material issues raised by the pleadings and evidence, unless they are waived, and *if the court renders judgment without making findings on all material issues, the case must be reversed.*" (Emphasis supplied)

J. J. Howell and Associates, Inc. v. Antonini, 124 Cal. App. 2d 388 [268 Pac. 2d 557]. At page 391 of 124 Cal. App. 2d:

> "Where an action is tried before the court without a jury, in the absence of a waiver, findings are required upon all material issues presented by the pleadings and the evidence. *If the court renders judgment without making such findings, the judgment must be reversed.* (*Hicks v. Barnes,* 109 Cal. App. 2d 859, 862 [241 P. 2d 648].)" (Emphasis supplied)

The rule that findings must be made on all material issues is particularly applicable in actions involving fraud. As stated in *23 Cal. Jur.* 2d 218, §87:

> "Allegations of fraud are serious charges, and ordinarily a finding should be expressly made on each issue presented."

Illustrative of the many cases sustaining the rule as applied to fraud actions are the following:

Golson v. Dunlap, 73 Cal. 157 [14 Pac. 576]. At page 164 of 73 Cal.:

> "The ultimate ground upon which transactions between trustees and *cestui que trust* are set aside

> is fraud, actual or constructive, as the case may be; and the rules of pleading require that the facts constituting the fraud (of which this is one) shall be set forth. Being properly pleaded, such facts must be found. For, under our system, whatever is properly in issue must be found, unless there are other issues which effectually and finally dispose of the case."

Field v. Austin, 131 Cal. 379 [63 Pac. 692]. At page 382 of 131 Cal.:

> "The above findings, it is quite clear, do not respond to the issues as to fraud made by the allegations of the answers, and the case therefore stands without findings as to these issues."

Judgment for plaintiff was reversed by reason of the court's failure to find upon the issue of fraud and other issues involved.

Floyd v. Tierra Grande Development Company, 51 Cal. App. 654 [197 Pac. 684]. At page 664 of 51 Cal. App.:

> "Allegations of fraud being serious in their effect, a finding should ordinarily be expressly made by the court on each issue presented. Fraud is never presumed. It must be satisfactorily proved."

Strong v. Strong, 22 Cal. 2d 540 [140 Pac. 2nd 386]. At page 546 of 22 Cal. 2d:

> "In the present case there was not only no pleading, but no finding of fraud, *and a judgment*

is not supported by proof of fraud if there is no finding of fraud. (Citations)" (Emphasis supplied).

James v. Haley, 212 Cal. 142 [297 Pac. 920]. At page 147 of 212 Cal.:

> "Ever since the adoption of the codes, it has been the rule that findings are required on all material issues raised by the pleadings and evidence, unless they are waived, and *if the court renders judgment without making findings on all material issues, the case must be reversed.* (*24 Cal. Jur.,* p. 935, sec. 183, and p. 940, sec. 186.)" (Emphasis supplied).

These principles are not only the well established rule in California, but also the rule followed in the Federal courts. So far as is pertinent, rule 52(a) of the Federal Rules of Civil Procedure provides as follows:

> "In all actions tried upon the facts without a jury, the Court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment . . . "

In *8 Cyclopedia of Federal Procedure* (Second Edition), page 34, par. 3144, the rule is thus stated:

> "The findings should conform to the issues made by the pleadings."

The case of *Felder v. Reeth,* 34 F. (2d) 744, a decision of the Circuit Court of Appeal for the 9th Circuit,

is cited in support of the text. That the rule as above stated has been followed in the 9th Circuit further appears from the decision in *Perry v. Baumann,* 122 F. (2d) 409. In that case the Court states at page 410, as follows:

> "Rule 52(a) of the Rules of Civil Procedure provides: 'In all actions tried upon the facts without a jury, the Court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment . . . '
>
> "It, therefore should have been followed in this case. Order reversed and case remanded to the District Court . . . "

The importance of specific findings as required and provided by rule 52(a) has been recognized by the Supreme Court of the United States. In the case of *Mayo v. Lakeland Highlands Canning Company,* 309 U. S. 310, the Court at page 316, states as follows:

> "It is of the highest importance to a proper review of the action of a Court in granting or refusing a preliminary injunction that there should be fair compliance with rule 52(a) of the Rules of Civil Procedure."

In the instant case not only has there not been a fair compliance with rule 52(a), but there has been an entire lack of compliance insofar as findings on the question of knowledge or scienter is concerned. Absent such finding, the judgment cannot be sustained. (*Wishnick v. Frye, supra*).

An examination of the court's findings of fact discloses that there is no finding whatsoever upon the matters alleged in paragraph IV of the complaint (that the representations in paragraph III were fraudulently made); upon the allegations of paragraph X of the complaint (that the allegations of paragraph IX were fraudulently made); or upon the allegations of paragraph XI (that the defendants fraudulently represented that the property was worth $38,000). Thus, there is no finding whatsoever that any of the statements or representations alleged to have been made by appellants were fraudulently made. In the absence of such findings the judgment predicated upon the court's conclusion of law that appellants committed both constructive and actual fraud under California law is entirely without support, and must be reversed.

VIII.

The Judgment Against Appellants Should Be Reversed With Instructions to the Court Below to Enter Judgment in Favor of Appellants on Their Counterclaim for Foreclosure as a Mortgage of the Deed of Trust Described in Said Counterclaim.

Appellees in paragraph II of their answer to the counterclaim admit that the payments due on the promissory note referred to in the counterclaim, from and after February 5, 1955, have not been paid. (Transcript of Record, p. 37). The reason advanced for the failure to make the payments are the matters alleged in the second cause of action of the complaint. It was stipulated at the trial that the payments had not been made, as appears at page 148 of the Transcript of Record:

> "Mr. Pollack: I think it is admitted that the payments weren't made, isn't that true?
>
> "Mr. Cutler: The payments were not made? Yes. I admitted in the answer to the counterclaim that you alleged that payments have not been made except—that payments have not been kept up on the second trust deed but they have on the first.
>
> "Mr. Pollack: Yes.
>
> "Mr. Cutler: Pending this action.
>
> "Mr. Pollack: Yes. And that the second trust deed is in default except for the defenses you have alleged.
>
> "Mr. Cutler: Yes. . . . "

We believe that we have demonstrated that the judgment against appellants is contrary to the law and the evidence and must be reversed. If this is so, then appellees have no defense to the counterclaim, as admittedly the payments required to be made by the promissory note secured by the second deed of trust have not been made, and appellants are entitled to judgment upon their counterclaim in accordance with the prayer thereof.

CONCLUSION

It is respectfully submitted that the judgment in favor of appellees and against appellants should be reversed, with instructions to the court below to enter judgment against appellees and in favor of appellants upon their counterclaim, for the balance due upon the promissory note referred to therein, and reasonable attorney fees, as therein provided, and for foreclosure as a mortgage of the deed of trust described in said counterclaim, in accordance with the prayer thereof.

Respectfully submitted,

LEO SHAPIRO
Attorney for Appellants,
George Wesley Stone and
Hildegarde W. Stone